COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Provision of Default Service	)	D.T.E. 02-40

INITIAL COMMENTS OF PG&E NATIONAL ENERGY GROUP REGARDING THE PROVISION OF DEFAULT SERVICE

I. INTRODUCTION

PG&E National Energy Group ("NEG") appreciates the opportunity to submit comments in response to the Order Opening Investigation into the Provision of Default Service ("Order") issued by the Department of Telecommunications and Energy ("Department") on June 21, 2002. NEG is a nation-wide independent energy company that generates electricity, operates interstate natural gas pipelines, and markets electricity and natural gas on a wholesale basis. NEG has 7,469 MWs of electric generating assets in operation and 3,000 MWs in development. In New England, alone, NEG has 5380 MWs of generating assets in operation.

Since 1998, NEG has been the wholesale supplier to Massachusetts Electric Company for 90.78% of its Standard Offer load, representing approximately 3,000 MWs of peak demand. NEG's contract to provide Wholesale Standard Offer Service expires in December 2004. As such, NEG has been and remains a major player in the energy industry in Massachusetts and New England.

Exactly three years ago from the date of issuance of this Order, the Department issued a Notice of Inquiry/Generic Proceeding into the Pricing and Procurement of Default Service (D.T. E. 99-60, June 21, 1999). NEG actively participated in that proceeding providing Initial and Reply Comments. The Department stated that it opened the present inquiry "to investigate all aspects of the manner in which default service is provided to ensure that it is compatible with the development of an efficient competitive market." (Order at 1). In addition, the Department stated, "the Department recognizes that we may not currently have the statutory authority to implement certain types of initiatives in these areas. However, if appropriate, the Department may use the results of this investigation to develop a report to the General Court on the provision of default service where necessary statutory changes can be considered." (Order at 6). Therefore, the principles and proposal that NEG will offer in this proceeding will not be limited by the current statutory language of the 1997 Massachusetts Electric Industry Restructuring Act[1] ("Restructuring Act"). NEG will offer a vision of post-transition default service that we believe will meet the Department's objective to provide for default service in a manner that is compatible with the development of an efficient competitive market.

NEG's comments are structured as follows: 1. A status of restructuring in Massachusetts; 2. Goals for post-transition default service as culled from the existing outstanding proposals; 3. NEG's principles for post-transition default service; 4. NEG's proposal; and 5. The benefits of NEG's proposal and how it fulfills the general goals.

II. STATUS OF RESTRUCTURING IN MASSACHUSETTS

The Restructuring Act states the following:

> Ratepayers and the commonwealth will be best served by moving from (i) the regulatory framework extant on July 1, 1997, in which retail electricity service is provided principally by public utility corporations obligated to provide ultimate consumers in exclusive service territories with reliable electric service at regulated rates, to (ii) a framework under which competitive producers will supply electric power and customers will gain the right to choose their electric power supplier.[2]

[1] St. 1997, c. 164, An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provision of Electricity and Other Services, and Promoting Enhanced Consumer Protection Therein.
[2] St. 1997, c. 164, s 1.

More than half way through the seven-year transition period, it is a good time to review what progress retail consumers have made in the competitive procurement of electricity.

As the Department notes in its Order and the Massachusetts Division of Energy Resources has shown by compiling the relevant statistics, a competitive retail market is developing to serve both large and medium commercial and industrial ("C&I") customers. As of April 2002, 42% of electricity consumed by large C&I customers was provided by the competitive retail market, an increase of almost 100 percent over the amount competitively provided as of September 2001. For medium C&I customers, approximately 16 percent of consumption was provided competitively as of April 2002, an increase of almost 500 percent over the amount that was competitively provided as of September 2001 (Order at 5, FN4). This trend does not hold for small C&I or residential customers. As of April 2002, for small C&I customers, seven percent of consumption was competitively provided by retail suppliers and for residential customers less than one percent of consumption was competitively provided by retail suppliers. (Order at 5, FN7). Therefore, one could posit that on this one measure of success (switching rates) the Restructuring Act has been generally successful for large and medium C&I customers and has yet to succeed for small C&I and residential customers.

Of course there are many other measures that demonstrate the success of the Restructuring Act. First, Massachusetts consumers have saved over a billion dollars in electricity bills from what they would have paid had the Restructuring Act not been enacted.[3] Second, thousands of megawatts of new generation have been developed in New England. Third, all of the new power plants employ state of the art gas-fired turbines that bring tremendous efficiency and environmental benefits to the region. Clearly, it is fair to say that the Restructuring Act has been largely successful; attractive competitive choice for small C&I and residential customers remains an ongoing challenge. Therefore, now is not the time for major changes to the Restructuring Act. The Department should be considering proposals that are consistent with the existing

[3] As of January 2001, Massachusetts's consumers saved $1.7 billion in electricity bills. (DOER 2000 Market Monitor Report).

direction of the Restructuring Act and should be looking to fine-tune certain aspects of it, in order primarily to enhance customer choice by removing barriers to the development of an efficient competitive market and creating an environment that encourages direct choices by customers.

III. GOALS OF POST-TRANSITION DEFAULT SERVICE

As the Department is aware, a number of stakeholders have been floating proposals for how post-transition default service should be structured.[4] Upon review of these proposals, it is apparent that the stakeholders agree on many of the basic goals that post-transition default service should seek to achieve.

Most of the stakeholders agree that post-transition default service should seek to achieve the following goals: (1) assure customers of stable and reasonable prices (i.e. reduce short-term price volatility); (2) facilitate migration to retail competition for small C&I and residential customers; (3) ensure that the price for default service is market driven; (4) maintain existing consumer protections (including low-income discounts); and (5) maintain a provider of last resort (whether it be the existing utility or a competitive supplier). In addition, some stakeholders seek to achieve the following goals: (1) provide a forward "price-to-beat" for buyers and sellers; (2) enhance wholesale market liquidity; (3) increase the choice of distinct retail products; and (4) require that the price for default service include all of the costs of providing the service.

It is instructive that many of the stakeholders hold similar goals for post-transition default service. It remains an open question whether achievement of all of these goals is possible at the same time. For example, is it possible to provide default service prices that are stable and low cost while also facilitating a migration to competitive retail suppliers? This begs the question as to exactly what type of service default service should be. The

[4] On June 21, 2002, a number of stakeholders (Massachusetts Electric, TXU, Nstar, DOER, Competitive Retail Suppliers, NCLC) presented proposals for post-transition default service at the Massachusetts Restructuring Roundtable. These proposals are available on the web site of the facilitator, Dr. Jonathan Raab at www.raabassociates.org.

Department has stated that "default service should function as a basic service that provides consumers with the appropriate incentives to turn to the competitive market for more sophisticated or advantageous service offerings." We agree with the Department on this point. We also think that to encourage customers to seek choices in the competitive marketplace, customers must raise their comfort level with making direct choices for electricity. NEG believes that both of these goals can be accomplished.

IV. NEG PRINCIPLES

NEG believes that there are a number of principles upon which post-transition default service should be based.

1. **Consistency with Restructuring –** The rules and procedures of post-transition default service must be consistent with the long-term objective of the Restructuring Act, a competitive marketplace for generation that provides choice of supply to consumers.
2. **Provider of Default Service –** Today, the provider of default service obligation belongs to the incumbent utilities. At least by the end of the transition period, NEG believes that the marketplace should assume this obligation. This would relieve T&D companies from an on-going load serving responsibility and allow them to concentrate on what they do best, provide reliable and cost effective transmission and distribution services.
3. **Default Service Parameters –** Default service must be a basic service. It should be a one-size fits all service with standard provisions and terms at a fixed price for at least three years. In this manner, the competitive market place will be allowed to develop and offer a full range of innovative market-based products for customers who wish to have more distinct products (i.e. floating rates, lower price in exchange for take or pay provisions, green products, etceteras.)
4. **Enhance Retail Migrations –** The structure of default service should enhance the migration of small C&I and residential customers to the competitive retail marketplace.

5. **Customer Information –** Customers should have access to sufficient transparent information to make an informed choice of supplier.
6. **Customer Choice –** Customers should have the ability to choose the service that they desire, whether that is a fixed price basic service (i.e. default service), a floating price, a green product, differing terms and conditions, etceteras. The T&D utility or the Department should not act as a proxy for customer choice. The customer knows best what he or she desires in a product.
7. **Safety Net –** Default service must maintain all of the existing consumer protections, in particular low-income subsidies.
8. **Volume Efficiencies –** Customers benefit from a market when volume efficiencies can be garnered. Customers will benefit in two ways:
   1. Lower costs through increasing efficiencies and amortizing fixed costs over larger volumes; and 2. Increased market stability. Otherwise the market structure is not sustainable. Therefore, arbitrary limitations on amount of load awarded to default suppliers are counterproductive.
9. **Switching Rules –** Retail service providers should not be able to game default service by sending customers continuously to and from default service based on price. Appropriate provisions on term and switching cost need to be in place prior to bidding on default service to prevent gaming.
10. **Credit Infrastructure –** Whoever collects customer funds must bear the credit risk. If billing and metering continues with the regulated utility, the utility should also be responsible for customer credit. Otherwise the competitive supplier should be able to bill directly to ensure that it can properly assert its rights against non-payment.
11. **Credit Insurance –** To ensure that suppliers (both default service and competitive retail suppliers) fulfill their contractual obligations and to assure customer confidence in the system, the Department must require that all suppliers of default and competitive retail services post sufficient credit.

V. NEG PROPOSAL

The following proposal, which admittedly requires additional detail, is offered for consideration by the Department in this proceeding. The proposal attempts to incorporate the principles enumerated above and builds off of where we are today, with the primary objective of getting customers comfortable with choice but still providing them with the security of a stable default service provider. We realize that this proposal has some significant differences from the proposals floated to date. In addition, we note that we have not had sufficient time to fully vet this proposal with other stakeholders. Nevertheless, we wish to offer it at this point as a starting point for further discussion and feedback.

NEG's proposal essentially accomplishes the following goals:

?? Establishes a basic provider of default service option.

?? Shifts the provider of default service load obligation, and the risks associated with that obligation, from the utility to competitive power companies.

?? Ensures that the default service option is based on market prices.

?? Allows a customer, not the utility or the Department as a proxy, to choose his default service provider.

?? Enhances retail market migration for all customers, but particularly for small C&I and residential customers.

?? Provides for a high level of consumer protection.

?? Maintains the role of the utility in providing metering and billing services.

NEG's proposal provides to consumers the ability to directly choose their provider of default service. We envision that default service will be provided by competitive companies under terms and conditions determined by the Department. The Department will determine the term, whether the price is fixed or not, migration rules and conditions, etceteras. We suggest that the Department provide for a basic service, with a fixed price over a set period of time (three years, for example). We suggest that the Department structure default service so that providers will compete on price, name and company reputation alone. In addition, the Department will determine the appropriate level of supplier financial assurance and other requirements necessary to be certified to offer default service.

On the other hand, Competitive Retail Suppliers will provide differentiated products under the same rules as they do today. These products may offer floating prices, green attributes, specific product mixes, special contract terms and conditions, conservation and load management services, other additional services, etceteras.

NEG offers for discussion the following new concept. Customers would make their choices for default service supplier via a ballot developed by the Department. The distribution of ballots would be done through the utilities. For example, approximately one year prior to the end of the transition period (perhaps on a staggered basis by franchise area), each customer class (e.g., small C&I, residential, large C&I, etc.) would receive a ballot. That ballot would list all suppliers of default service and their prices, for each franchise area. There would likely be different suppliers and different prices for each customer class and franchise area. As mentioned, the suppliers of default service would compete on price, name and company reputation alone, as the terms and conditions of default service would be rudimentary and already determined by the Department. If the customer failed to make a choice of default supplier on the first ballot, it is envisioned that the Department would have instituted a process to provide customers with a further notice and ramifications of not making a choice. Ultimately, if the customer fails to make a choice of default service supplier, one option would be for customers to be randomly assigned to the market participants who are offering default service, on a *pro rata* basis.

All default service suppliers would be required to provide a price as of a date certain, which date would be the same for all suppliers. The ballot would be open for a finite, pre-determined period of time (again, the same for all suppliers). The ballot would be redistributed every three years. To prevent gaming of the system between default service suppliers and competitive retail suppliers, customers would not be allowed back on default service once they had left to go with a competitive retail supplier. For new customers that do not choose a competitive retail supplier, one option could be that they would be randomly assigned to the market participants who are offering default service, on a *pro rata* basis.

NEG envisions that the utilities would continue to provide metering, billing, credit and collection and information services, as well as to recover in rates low income subsidies and the costs of customers who don't pay their bills. If non-payment costs are not captured in customer rates, the Department needs to provide a process for the default service suppliers to discontinue service to non-paying customers.

The ballots would not preclude customers from participating in other aggregations, like municipal aggregations, or remaining with their current competitive retail service provider.

VI. BENEFITS OF NEG PROPOSAL

NEG believes that this proposal achieves many of the goals expressed by stakeholders. First, customers of default service would be assured of a stable price at market rates (due to the fixed price nature of default service and the three year duration, there would be no volatility during that time period). Second, this proposal should facilitate migration of all customers, but particularly small C&I and residential customers, to competitive retail supply. Because default service is a basic service priced at retail and set for a period of time, competitive retail suppliers will have an easier time competing on price, distinguishing their products and offering additional value. In addition, the ballot proposal for default service will get customers accustomed to making a choice of electricity supplier. We think this is a critical component and will enhance migration to competitive retail suppliers. Third, the NEG proposal would maintain all existing consumer protections for anyone on default service. Fourth, a provider of last resort would be maintained; the obligation would simply be shifted to the competitive market place. Fifth, this proposal provides a forward "price-to-beat" for buyers and sellers. Finally, although not mentioned as a goal in other proposals, but important nonetheless, this proposal offers customers a choice of default service provider, something no other proposal would do.

VII. CONCLUSION

Once again, NEG appreciates the opportunity to comment in this proceeding. We hope that the principles enumerated above will assist the Department. In addition, we offer for discussion and feedback a proposal with some different aspects from proposals floated to date. Our proposal provides customers with a greater degree of choice than the other proposals and meets the objectives of most of the proposals. We look forward to additional discussion and feedback.

Sincerely,

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Thomas E. Bessette, Esq.
Director-External Affairs and Market Rules
PG&E National Energy Group
One Bowdoin Square
Boston, MA 02124-2910

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